Mario Draghi: Hearing at the Committee on Economic and Monetary Affairs of the European Parliament

Introductory statement by Mr Mario Draghi, President of the European Central Bank, for the Hearing at the Committee on Economic and Monetary Affairs of the European Parliament, Brussels, 8 July 2013.

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Madam Chair,

Honourable members of the Committee on Economic and Monetary Affairs,

It is a great pleasure for me to be back with your committee for our last exchange of views before the summer break.

At this time, it is worth taking stock of progress over the past 12 months. Clearly, financial conditions in the euro area today are more stable and resilient than they were last summer. This is partly due to our determined monetary policy actions. Governments and parliaments have also played a key role in the relative return of confidence and stability by undertaking courageous reforms, at both the national and European levels.

Yet despite this progress, the euro area still faces considerable challenges. The economy is still weak. Financial fragmentation remains. This challenges the very concept of the Single Market. Small and medium-sized enterprises (SMEs) can find it difficult to access credit, particularly in countries under strain; and several key steps remain to be taken to complete the banking union. These are the three topics that I will address in turn today.

1. Economic and monetary developments

Let me first briefly discuss our recent monetary policy decisions. In May, the Governing Council of the European Central Bank (ECB) decided to lower the interest rate on the main refinancing operations by 25 basis points to 0.50% and the rate on the marginal lending facility by 50 basis points to 1.00%. The rate on the deposit facility was left unchanged at 0%. These policy decisions took account of subdued underlying inflationary pressures over the medium term and they are expected to improve funding conditions across the whole monetary union.

Following its July meeting, the Governing Council stressed that the monetary policy stance is geared towards maintaining the degree of monetary accommodation warranted by the outlook for price stability and promoting stable money market conditions.

It reiterated that its monetary policy stance will remain accommodative for as long as needed. Furthermore, the Governing Council sharpened its communication by announcing that it expects the key ECB interest rates to remain at present or lower levels for an extended period of time. This expectation was based on the overall subdued outlook for inflation extending into the medium term, given the broad-based weakness in the real economy and subdued monetary dynamics. In the period ahead, we will monitor all incoming information on economic and monetary developments and assess any impact on the outlook for price stability.

The accommodative stance of our monetary policy, together with the significant improvements in financial markets since mid-2012, should help to support prospects for an economic recovery later in the year and in 2014.

On non-standard measures, the Governing Council decided in May to continue conducting all refinancing operations as fixed-rate tender procedures with full allotment, at least until mid-July 2014. This measure will help to support a smooth transmission of the ECB's monetary policy stance. In particular, it will ensure that banks' lending decisions are not impaired by funding constraints.

The Governing Council also decided in May to start consultations with other European institutions on initiatives to promote a functioning market for asset-backed securities (ABS) collateralised by loans to non-financial corporations.

Before discussing this issue in more depth, let me briefly comment on the economic outlook. Economic activity in the euro area contracted for a sixth consecutive quarter in the first quarter of 2013. Labour market conditions remain weak. Recent confidence indicators based on survey data have shown some further improvement, albeit from low levels. Overall, euro area economic activity should stabilise and recover over the course of the year, although at a subdued pace.

The risks surrounding the economic outlook for the euro area continue to be on the downside. The recent tightening of global money and financial market conditions and related uncertainties may have the potential to negatively affect economic conditions. Other downside risks include the possibility of weaker than expected domestic and global demand and slow or insufficient implementation of structural reforms in euro area countries.

Annual inflation in the euro area has continued to moderate, falling from 2.5% in 2012 to 1.6% in June. Looking ahead, the underlying price pressures over the medium term are expected to remain subdued, reflecting the broad-based weakness in aggregate demand and the modest pace of the recovery. Inflation expectations nonetheless continue to be firmly anchored in line with the Governing Council's aim of maintaining inflation rates below, but close to 2%.

Risks to the outlook for price developments are expected to be still broadly balanced over the medium term. Upside risks relate to stronger than expected increases in administered prices and indirect taxes, as well as higher commodity prices. Downside risks stem from weaker than expected economic activity.

Consistent with our expectations of low underlying inflationary pressures over the medium term, monetary and, in particular, credit dynamics remain subdued. The annual growth rate of loans to the private sector remains negative. To a large extent, weak loan dynamics continue to reflect primarily the current stage of the business cycle, heightened credit risk and the continuing adjustment of financial and non-financial sector balance sheets.

2. Financial fragmentation and SME financing

Let me now turn to the second topic namely the financing of SMEs. It is important to recall that the euro area financial system is mainly bank-based: around 80% of the debt of non-financial corporations consists of bank loans. There can be no sustained recovery without a sound banking system capable of effectively intermediating funds across the whole euro area.

Over the recent past, this intermediation process has suffered from two issues:

First, financial fragmentation, between peripheral and core countries; and

Second, higher challenges for SMEs relative to large firms.

On the first issue, lending rates are very heterogeneous across euro area economies. This reflects divergent bank funding conditions as well as country-specific macroeconomic developments that affect the creditworthiness of borrowers. The ECB took action, within our mandate, to alleviate this fragmentation: explicitly, we took action that alleviated funding constraints and reduced the dispersion of bank funding costs not least through the three-year long-term refinancing operations (LTROs). Still, the dispersion in lending rates across countries and borrowers remains substantial.

As regards the second issue, access to financing is more challenging for SMEs than for large firms. Spreads between bank lending rates for small-sized loans and large loans are still high by historical standards, although they have broadly declined since the last quarter of 2012. Difficult access to credit by SMEs is an issue for investment and growth in parts of the euro area, especially in countries under strain.

In Spain, for instance, the interest rate on small loans is almost 2.3 percentage points greater than interest rates on large loans. In France, by contrast, the difference is only 1 percentage point. Given their high dependence on bank credit, SMEs in countries under strain suffer particularly from financial fragmentation.

In this context, the Commission and the European Investment Bank (EIB) are looking into possible ways to support SME financing, notably in the form of joint risk-sharing instruments. These would combine the lending capacity of the EIB and the European Investment Fund as well as resources from national promotional banks to finance special activities in EU priority areas.

A number of options – of both a short- and longer-term nature – are being explored, including the provision of guarantees, credit enhancements of SME loan pools to revive structured credit markets over a longer time horizon; and third, purchases of asset-backed securities (ABS) by the Commission and the EIB.

Initiatives to foster the developments of the capital market, including the securitisation market, to complement the role of the banking system are particularly useful in the euro area.

With respect to securitisation, we have to be aware of the numerous constraints on the revival of ABS public issuance. These include in particular some proposed changes to the regulatory framework, which may reduce incentives to invest in certain types of ABS in the long term. Such constraints need to be properly addressed. The regulatory treatment for securitisation should acknowledge the credit performance and ensure an unbiased level playing field with other securities regarding risk, rating and maturity.

I would also like to make clear that with regard to the ABS market the ECB now has an advisory role.

3. Banking union

Policy-makers have made strong commitments on moving towards banking union – now it is essential to deliver on those commitments. The objective is effectively threefold: reinstating beyond doubt the soundness of the banking system; re-integrating the banking system; and delivering a supervisory and resolution framework that will prevent a repeat of the past risk build-up.

All core elements should fall into place swiftly to reap the full benefits of a banking union. The stakes are too high to afford undue delays. To complete such an essential project, resolute action has to be taken in the months to come – and this Parliament has a key role to play.

First, until the regulation on the single supervisory mechanism (SSM) is adopted, we at the ECB cannot formally take decisions. In this context, it is my understanding that the supervisory accountability arrangements with the Parliament, in line with the SSM regulation, are nearing finalisation on the basis of a constructive stance by both parties.

In view of the adoption of the regulation, we have already launched the process of internal preparations, on which I would like to give you a brief update.

We are working in close and constructive cooperation with the national authorities for the establishment of the SSM. This includes five main workstreams: first, mapping the euro area banking system to identify in particular systemic institutions; second, addressing legal issues in the development of the new supervisory processes at SSM level; third, preparing a harmonised supervisory data reporting framework; fourth, developing a supervisory model and manual; and fifth, designing and implementing the balance sheet assessment required by the SSM Regulation.

Let me be clear about the importance of that fifth workstream. A credible and thorough balance sheet assessment is an indispensable step towards restoring full confidence in the banking system. Transparency on asset valuation is necessary to subsequently assess the capital position of banks and also to facilitate market transactions on bank assets.

The balance sheet assessment will be complemented by a stress test, in coordination with the European Banking Authority, that will cover all banks supervised directly by the ECB. We expect to conclude the comprehensive assessment when the SSM becomes operational. It is crucial to have a commitment to ensure that effective backstops are available, in order to ensure that the assessment is duly and timely concluded.

A second cornerstone of banking union is the Bank Recovery and Resolution Directive (BRRD). By providing the tools and powers in national laws, it will form a basis on which to build a single resolution mechanism (SRM). The ECB welcomes the fact that an agreement on BRRD was reached at the last ECOFIN meeting. I trust that this Parliament, together with the Council, will reach an agreement by the end of this year.

This will in turn pave the way for a swift entry into force of the European Stability Mechanism's direct bank recapitalisation instrument. We welcome the political agreement reached at the last Eurogroup meeting. This instrument will usefully complement the existing European backstop and will contribute to the further decoupling of banks from their respective sovereigns.

A single resolution mechanism is the next crucial pillar of the banking union. It is an indispensable complement to the single supervisor and should ideally be in place once the SSM is operational. The ECB looks forward to the Commission's proposal for an SRM with a strong single resolution authority at its heart and a single resolution fund at its disposal.

Thank you for your attention. I am now looking forward to your questions.